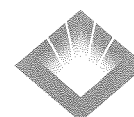


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February 11, 2004

VIA FACSIMILE (808-587-3820)
AND E-MAIL (mtome@dbedt.hawaii.gov)



TESORO

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Ms. Maria Tome
Alternate Energy Engineer
Hawaii State Energy Office
The Hawaii Fuel Ethanol Working Group
P.O. Box 2359
Honolulu, Hawaii 96804

Comments by Tesoro Hawaii Corporation on Unofficial Draft Administrative Rules (dated January 30, 2004)

Dear Ms. Tome:

Thank you for the opportunity to participate in the recent meetings of the Ethanol Working Group to discuss the unofficial draft administrative rules relating to ethanol content requirement. The main purpose of this letter is to supplement our comments in our prior letter to you dated December 19, 2003 ("December 19 Letter") and to provide our comments on the latest unofficial draft administrative rules dated January 30, 2004 (the "Draft Rules").

Introduction

Before we begin with our comments, we want to acknowledge our appreciation for all of the hard work that has gone into this endeavor by the entire Ethanol Working Group and want to reiterate Tesoro Hawaii Corporation ("Tesoro") support for the State of Hawaii's energy policy and desire to increase the security and self-sufficiency of energy supplies to the region.¹ Tesoro appreciates the importance of ethanol to the agricultural segment of our State. It is our belief that a successful ethanol program would further the State's energy policies by facilitating the development of an Hawaii-based ethanol industry engaging in the sustainable development of Hawaii's energy resources. This would greatly benefit the local agriculture industry and result in the increased economic activity in the State.

The challenge, of course, is structuring rulemaking and legislation in a manner that actually achieves these worthwhile goals. From a conceptual standpoint, in order to attain these goals while being fair to all involved, we believe that current

¹ For example, Hawaii Revised Statutes Section 226-18 states as one of the State's facility systems objectives is to increase "energy self-sufficiency where the ratio of indigenous to imported energy use is increased".

and future legislation and rulemaking need to be closely coordinated to address the various facets involved in the local production, use and distribution of ethanol and ethanol products.

As stated in our recent testimony before the Hawaii Legislature regarding S.B. 2993 (Ethanol Income Tax Credit) and S.B. 3207 (Ethanol Income Tax Credit), Tesoro is opposed to the current State mandate that gasoline manufacturers and distributors sell blended gasoline that contains 10 percent ethanol. We are concerned that the ethanol mandate will result in only limited local production of ethanol using only the current molasses production for the feedstock. The petroleum industry distributors such as Tesoro will be adversely affected by the implementation of the ethanol mandate by the necessity to build infrastructure at each terminal such as tanks to contain ethanol for blending. As noted in our December 19, 2003 Letter, the State of Hawaii has provided generous tax credits to the ethanol producers in addition to the 53 cent/gallon excise tax credit and 10 cent/gallon federal income tax credit they currently enjoy. However, no such incentives exist for gasoline distributors incurring the considerable capital expense needed to introduce the ethanol program in Hawaii.

As further noted in our December 19 Letter, blending of gasoline with ethanol will require a reconfiguration of the gasoline blending practices at the Tesoro refinery. Volatile components normally present in gasoline must be removed to reduce the gasoline's Reid Vapor Pressure. These components will be exported at much lower prices. The pending price cap law currently references price quotes that do not include any ethanol blends. Consequently the price control legislation will not allow for recovery of these additional costs associated with ethanol blending in Hawaii.

If these issues and others are not properly addressed, the ethanol program may have unintended adverse results and, at the same time, will not achieve the State's important goals for the program. It is imperative to the success of the ethanol program that the proposed rules are not prematurely issued without the consideration and/or passage of such legislation. Together, the legislation and the Draft Rules should present a comprehensive ethanol program that will achieve all of our goals.

The focus of this letter, however, is to comment on the Draft Rules. Overall, we believe that the current Draft Rules are a step in the right direction. However, we note that there are a number of areas, some of which we have previously addressed in our December 19 Letter, that need to be addressed in order for the Draft Rules to better address the overall purpose of the ethanol program and the State's goals.

COMMENTS – PROPOSED CHANGES TO DRAFT RULES

1. As discussed in our December 19 Letter, the Draft Rules do not require local ethanol producers to provide a sufficient supply of ethanol to meet the mandate schedule proposed in the Draft Rules, or even to forecast the availability of the ethanol supply. Without a reliable local supply of ethanol, the State would not realize the exponential value of supporting the ethanol industry and the economic multiplier effect across various business sectors.

Statewide, about 400 million gallons of gasoline are sold per year. Based on the 10 percent mandate, 40 million gallons of ethanol would be needed each year in Hawaii. Targeting even 85% of 40 million gallons of local ethanol production would dramatically increase the amount of agricultural feedstock needed and would require a corresponding increase in agricultural production to make up the difference.

If, however, ethanol is imported into the State, none of these benefits would be realized in Hawaii; only out-of-state or foreign ethanol producers would gain at the expense of Hawaii's residents and businesses. Thus, in this scenario, the Draft Rules would have the unintended result of promoting imported out-of-state ethanol – in essence replacing one imported fuel with another. Moreover, if sufficient local production of ethanol does not come to fruition, acknowledged as a possibility by Maui Ethanol during the Ethanol Working Group meeting, the prospect of repealing the ethanol mandate could become a reality. This would be unfair to Tesoro and other distributors who would have invested millions of dollars into ethanol infrastructure.²

If the mandate is retained against our recommendations, Tesoro proposes changing the implementation date of the proposed mandate for ethanol blending such that it is contingent on a certain threshold of local ethanol production.³

² From Tesoro's perspective, the prospect of the State repealing the ethanol mandate as a result of insufficient local production would come at tremendous cost. Ethanol must be shipped and stored as a separate product until it is blended with gasoline at terminals on Oahu and the neighbor islands. The current law provides generous tax credits to ethanol producers for their capital investments; however, these same benefits are not extended to petroleum distributors such as Tesoro. This is inequitable because distributors would be subject to significant upfront costs to build infrastructure such as tanks to contain ethanol for blending. This would be the case especially if there is insufficient local supply and Tesoro Hawaii would have to import ethanol to meet the requirements of the mandate.

³ Tesoro notes that several members of the Ethanol Working Group have experience building ethanol blending facilities in other states and building tanks in Hawaii. The consensus of the distributors is that the time to build facilities in Hawaii is between two and three years, with

Specifically, Tesoro proposes using the in-service date of local ethanol production facilities that will produce at least 34 million gallons of ethanol a year. While 40 million gallons of local ethanol production would be ideal, Tesoro believes that the 34 million gallon target is a realistic compromise. This compromise would give the ethanol producers the certainty that their product would be needed if they build their plants while giving Tesoro, and the other distributors, the assurance that we will not make large investments in tanks and blending facilities that are either never used or are used only to blend imported out-of-state ethanol.

2. If the mandate is not lifted, Tesoro believes that the current ethanol program should require all gasoline be 10% ethanol by volume. As discussed in the December 19 Letter, a gradual rollout is expensive and impractical given the need for a dual system while the rollout is in process. Tesoro has provided suggested language in the redlined draft of the Draft Rules attached to this letter.

3. The Draft Rules essentially require the gasoline distributors to manage the ethanol supply in the State in order to achieve compliance with the ethanol mandate. As written, the Draft Rules require the distributor to apply for exemptions in the event that sufficient quantities of competitively priced ethanol are not available to meet the minimum requirements. Under the Draft Rules, it can take up to 45 days for the exemption request to be heard. In addition, the rules allow for a retroactive exemption in the case of unforeseen circumstances that allows for up to 105 days before a ruling from the Petroleum Commissioner.

While Tesoro notes that the Ethanol Working Group added a provision to the current Draft Rule stating that no fines or penalties accrue in the time between the application for a waiver and the ruling on the application for an exemption under paragraph (a) (1) of section 15-____-9, it is not clear whether fines can still accrue for the 105 days allowed under a retroactive request for exemption. Tesoro proposes that paragraph (e) (3) be changed to state that no assessments or penalties shall accrue during the period that a retroactive exemption is being considered. We have provided suggested language in the attached redlined draft of the Draft Rules.

4. As noted in our December 19 Letter relating to the motor vehicle warranty issue, Tesoro notes that the addition of ethanol is mandated by the State and is produced by parties other than the distributors. Since Tesoro does not have oversight of the ethanol production facilities and/or is not involved in quality

permitting taking up a large and unpredictable amount of this time. Despite this experience, the Ethanol Working Group proposed amending the implementation schedule to take effect 18 months after the finalization of the rules. As discussed herein, Tesoro believes that this would not be in the best interest of the State or the ethanol program as there is no guarantee of any ethanol production in the State.

control of the ethanol it receives, Tesoro requests that the Draft Rules be amended to include a waiver of product liability for the distributors against any possible motor vehicle damages incurred as a result of the introduction of ethanol into the State's gasoline pool.

5. As pointed out in our December 19 Letter, the definition of "Distributor" in Section 7(1) of the Draft Rules should be further examined to ensure that there is no confusion as to which party is responsible for the ethanol blending and related issues such as the tax credit. This is particularly important when the "Before Oxygenated Blend" will be handled by multiple parties prior to rack, and in situations where one distributor is using the facilities of another distributor to distribute its gasoline. This issue should be viewed in light of current and proposed legislation as well.

6. Tesoro notes that the current mandate requires that 85% of the gasoline a distributor sells contain ten per cent ethanol on a monthly basis. We believe that the requirement be averaged over a calendar year to allow for operational problems at an ethanol plant, refinery, or import terminal as well as allowing for routine maintenance. In this way a distributor would have the option to discontinue blending ethanol for a short time and be able to "catch up" by blending at a greater than 85% rate later in the year. With a requirement to average 85% on a monthly basis there would be no practical way to respond to a supply disruption without violating the mandate.

7. Tesoro proposes that any ethanol blended into E85 count toward a distributors required ethanol use at a rate of one gallon of E85 counting as 8.5 gallons of ten percent ethanol blend.

* * * * *

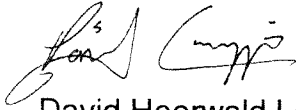
This concludes Tesoro's follow up remarks on the Draft Rules and the proposed changes. We appreciate the opportunity to provide these comments, and believe the Ethanol Working Group is serving an important role in identifying and addressing the issue of ethanol in Hawaii. Tesoro looks forward to continuing working with the Ethanol Working Group.

Ms. Maria Tome
February 11, 2004
Page 6 of 6

If you have any questions or if I can be of any assistance, please do not hesitate to contact me at 285-1565 or by e-mail at dleonard@tesoropetroleum.com.

Yours very truly,

TESORO HAWAII CORPORATION

 on behalf of

David Heerwald Leonard, P.E., Esq.
Vice President and General Counsel

cc: Paul Cannizzo
Kathleen Fitzgerald

enclosures

HAWAII ADMINISTRATIVE RULES

TITLE 15
DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND
TOURISM

CHAPTER ____
ETHANOL CONTENT REQUIREMENT

SUBCHAPTER 1 - IN GENERAL

- § 15-__-1 Purpose.
- § 15-__-2 Definitions.

SUBCHAPTER 2 - IMPLEMENTATION OF HRS § 486J-10

- § 15-__-3 Schedule of ethanol content requirement.
- § 15-__-4 Minimum ethanol content requirement.
- § 15-__-5 Monitoring of ethanol content.
- § 15-__-6 Ethanol based additives.
- § 15-__-7 Monthly reporting requirements of
distributors.
- § 15-__-8 Opportunity for quarterly reporting by
distributors.

SUBCHAPTER 3 - EXEMPTIONS

- § 15-__-9 Request for an exemption.
- § 15-__-10 Process for granting an exemption.

SUBCHAPTER 4 - VIOLATIONS, SEVERABILITY AND
ENFORCEMENT

- § 15-__-11 Violations.
- § 15-__-12 Severability.
- § 15-__-13 Referral to attorney general.

Historical Note: The mandate requiring blending of ten per cent ethanol in motor fuel in the State was originally introduced in 1994 through Act 199. The ethanol mandate language in Act 199 became part of

chapter 486E, Hawaii Revised Statutes. Chapter 486E was replaced in 1997 by Chapter 486J, Hawaii Revised Statutes. Substantive changes relative to the ethanol blending mandate have been made to incorporate provisions of Act 77, SLH 2002, which amended chapter 486J, Hawaii Revised Statutes, by: 1) requiring the "petroleum commissioner" to refer intentional violations to the attorney general, who may exercise appropriate legal or equitable remedies available to the State; and 2) changing references to the department and the director of business, economic development, and tourism in the Petroleum Reporting Act to the "petroleum commissioner", who is to be the head of the department's energy, resources, and technology division.

SUBCHAPTER 1 - IN GENERAL

§ 15-__-1 Purpose. The purpose of this chapter is to provide rules governing implementation of the requirement that gasoline sold in the State for use in motor vehicles contain ten per cent ethanol by volume, as authorized under chapter 486J-10, Hawaii Revised Statutes. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-2 Definitions. As used in this chapter, unless a different meaning clearly appears in the context:

"Certified" means signed by an authorized company representative and declared to be complete, true, and accurate.

"CIF Honolulu terminal" denotes the quoted sales price of motor fuel, which includes the cost, insurance, excise tax, and freight charges to any terminal in Honolulu, Hawaii.

"Comparable grade" means the grade, based on octane rating, of the finished (blended) fuel.

"Regular" refers to gasoline having an octane rating greater than or equal to 85 and less than 88.

"Midgrade" refers to gasoline having an octane rating

greater than or equal to 88 and less than or equal to 90. "Premium" refers to gasoline having an octane rating greater than 90.

"Competitively priced" means fuel-grade ethanol CIF Honolulu terminal for which the wholesale price, minus the value of all applicable federal, state, and county tax credits and exemptions, is not more than the average posted wholesale rack price of unleaded gasoline of comparable grade, as published by the U.S. Department of Energy, Energy Information Administration in Petroleum Marketing Monthly, Table 31 and available on the Energy Information Administration website, or as otherwise published or posted, as prescribed by the petroleum commissioner.

"Denatured fuel ethanol" means fuel-grade ethanol which meets specification ASTM D 4806, "Standard Specification for Denatured Fuel Ethanol for Blending with Gasoline for Use as Automotive Spark Ignition Engine Fuel" published by the American Society for Testing and Materials.

"Distributor" means and includes:

- (1) Every person who refines, manufactures, produces, or compounds fuel in the State, and sells it at wholesale or to retail dealers;
- (2) Every person who imports or causes to be imported into the State or exports or causes to be exported from the State, any fuel;
- (3) Every person who acquires fuel through exchanges with another distributor; and
- (4) Every person who acquires fuel from a licensed distributor as a wholesaler thereof.

"Gasoline" includes conventional, oxygenated, and reformulated gasolines.

"In-Service Date" means the date that the Petroleum Commissioner provides public notice that the conditions required to implement these rules are satisfied, including that the ethanol production facilities within the State of Hawaii with an aggregate rated nameplate capacity of at least thirty-four million gallons of ethanol per year are capable

of producing eighty-percent (80%) of the name plate capacity on a consistent basis.

"Person" means any person, firm, association, organization, partnership, business trust, limited liability corporation, corporation, or company.

"Person" also includes any city, county, public district or agency, the State or any department or agency thereof, and the United States to the extent authorized by federal law.

"Petroleum commissioner" or "commissioner" means the administrator of the energy, resources, and technology division of the department of business, economic development, and tourism.

"Retail dealer" means and includes a person who purchases liquid fuel from a licensed distributor, and sells the liquid fuel at retail. Only sales of gasoline for consumption or used by the purchaser, and not for resale, are sales at retail.

"Ten percent ethanol by volume" means a blend of gasoline and ethanol which has an ethanol content, exclusive of denaturants and permitted contaminants, that is not less than 9.2 percent by volume and not more than 10.0 percent by volume of the blend as determined by an appropriate United States Environmental Protection Agency or American Society of Testing Materials standard method of analysis of alcohol content in motor fuels. [Eff.] (Auth: HRS §§ 486J-1 and 486J-10) (Imp: HRS §§ 486J-1 and 486J-10)

SUBCHAPTER 2 - IMPLEMENTATION OF HRS § 486J-10

§ 15-__-3 Schedule of ethanol content requirement. Starting no later than ~~eighteen~~ twelve months after the ~~In-Service Date~~ Date of ethanol production facilities within the State of Hawaii with an aggregate rated nameplate capacity of at least thirty-four million gallons per year ~~promulgation of this rule, at least eighty five percent of all~~ gasoline supplied to a retailer, sold at retail, or sold to a private, state, or municipal fleet for use in motor vehicles, and intended as a final product for

fueling motor vehicles in the state of Hawaii, shall contain ten percent ethanol by volume. ~~The Petroleum Commissioner shall provide public notice when the conditions required to implement these rules are satisfied.~~ [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-4 Minimum ethanol content requirement.
Each distributor supplying fuel to one or more retail stations or to one or more private or municipal fleets shall meet the minimum ethanol content requirement of this chapter on a ~~monthly~~ yearly basis. [Eff.]
(Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-5 Monitoring of ethanol content.
Distributors shall permit the petroleum commissioner or authorized agent(s) thereof to inspect the rack meter loading facilities of the distributor, take samples, and review records during regular business hours to ensure the mandated volume of ethanol is included in gasoline sold by the distributor. [Eff.]
(Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-6 Ethanol based additives.
(a) Gasoline sold in the State, for use in motor vehicles, which is blended with an ethanol-based product, such as ethyl tertiary butyl ether, shall be considered to be in conformance with this chapter if the quantity of ethanol used in the manufacture of the ethanol-based product represents ten per cent, by volume, of the finished motor fuel.

(b) Ethanol used in the manufacture of ethanol-based gasoline additives, such as ethyl tertiary butyl ether, may be considered to contribute to the distributor's conformance with this section; provided that the total quantity of ethanol used by the distributor is an amount equal to or greater than the amount of ethanol required under this section. [Eff.]
(Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-7 Monthly reporting requirements of distributors. (a) Each distributor shall file with

the petroleum commissioner monthly in the manner and on forms prescribed, prepared and furnished by the petroleum commissioner, a statement certified by the chief executive officer or other authorized officer of the distributor showing:

- (1) The number of gallons of fuel-grade ethanol purchased by the distributor during the calendar month of the report;
- (2) The price and amount of ethanol available for sale by the distributor during the calendar month of the report;
- (3) The number of gallons of ethanol blended gasoline, by grade, purchased during the calendar month of the report;
- (4) The number of gallons of non-ethanol-blended gasoline purchased by the distributor during the calendar month of the report;
- (5) The number of gallons of ethanol-blended gasoline, by grade, sold by the distributor during the calendar month of the report;
- (6) The number of gallons of non-ethanol-blended gasoline, by grade, sold by the distributor during the calendar month of the report;
- (7) The complete name and address of supplier or suppliers from whom the distributor purchased the ethanol or ten per cent ethanol blended gasoline reported above; and
- (8) Any other information the petroleum commissioner determines from time to time as being required to ensure compliance with chapter 486J-10, Hawaii Revised Statutes.

(b) Individual retail dealers shall not be required to file the monthly report unless they are also a distributor or compound or blend ethanol into gasoline other than at the distributor's terminal loading rack.

(c) The monthly report shall be filed on or before the last day of the calendar month following the month of the report.

(d) In the case of a failure to file a monthly report required under this section on the date and in the manner prescribed herein, or a failure to include

any of the information required to be shown on the monthly report filed under this section or to show the correct information, the distributor shall be assessed \$300 for each day during which the failure continues. The maximum penalty under this subparagraph on failures with respect to any one monthly report shall not exceed \$10,000.

(e) Payment of late filing fees imposed pursuant to this section must be made by cash, cashier's check, or certified check made payable to the "State of Hawaii" and delivered to the petroleum commissioner. The name of the distributor for whom payment is made should be written on the check. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-8 Opportunity for quarterly reporting by distributors. (a) Upon satisfying the ethanol blending and reporting requirements on a timely basis for at least six consecutive months, the distributor, upon notification by the petroleum commissioner, may elect to file quarterly reports, in lieu of monthly reports.

(b) Quarterly reports shall be filed, in the manner and on forms prescribed, prepared and furnished by the petroleum commissioner, for quarters ending on March 31, June 30, September 30 and December 31.

(c) Reports shall be filed on or before the last day of the calendar month following the last month of the quarterly report.

(d) In the case of a failure to file a quarterly report required under this section on the date and in the manner prescribed therefor, or a failure to include any of the information required to be shown on the quarterly report filed under this section or to show the correct information, the distributor shall be assessed \$300 for each day during which the failure continues. The maximum penalty under this subparagraph on failures with respect to any one quarterly report shall not exceed \$10,000.

(e) Payment of late filing fees imposed pursuant to this section must be made by cash, cashier's check, or certified check made payable to the "State of

Hawaii" and delivered to the petroleum commissioner. The name of the distributor for whom payment is made should be written on the check.

(f) In the case of failure to meet the ethanol blending or quarterly reporting requirements, and upon notification by the petroleum commissioner, distributors previously approved for quarterly reporting may be required to once again file monthly reports, in lieu of quarterly reports, beginning with the calendar month in which notice of such is given by the commissioner. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

SUBCHAPTER 3 - EXEMPTIONS

§ 15-__-9 Request for an exemption. The petroleum commissioner may authorize the sale of gasoline that does not meet the requirement of ten per cent ethanol if the petroleum commissioner determines that:

(a) Sufficient quantities of competitively-priced ethanol are not available to meet the minimum requirements of this chapter; or

(b) In the event of any other circumstance for which the petroleum commissioner determines compliance with this chapter would cause undue hardship. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-10 Process for requesting an exemption.
(a) To obtain an exemption, in whole or in part, from the ethanol blending requirements, a distributor shall submit to the petroleum commissioner, in a manner allowed by the petroleum commissioner, a request for exemption, along with supporting documentation which must demonstrate that--

- (1) Sufficient quantities of competitively-priced ethanol are not available to meet the minimum requirements of this chapter; or
- (2) Compliance with the ethanol blending requirement would cause undue hardship.

(b) Requests for exemption may be submitted at any time and must be accompanied by supporting documentation.

(c) Exemptions may be granted for up to 90 days, and they may be renewed, if supporting documentation is provided.

(d) Exemptions may be granted in whole or in part. When granting an exemption in part, the commissioner may, depending upon the circumstances, completely relieve a distributor from complying with a portion of blending requirements, or the commissioner may require a distributor to blend all or some of the exempted fuel in future months.

(e) If a distributor is seeking an exemption --

- (1) Under paragraph (a)(1) of this section, the types of documentation that are to accompany the request must include, but are not limited to, actual price and quantity quotes from vendors or suppliers, with contact information (address, phone number, email, and website) of said vendors and suppliers, and additional documentation that exhibits good faith efforts to meet the ethanol blending requirement; or
- (2) Under paragraph (a)(2) of this section, the distributor must identify what portion of the ethanol blending requirement should be subject to the exemption, describe the specific nature of the hardship that precludes compliance, with documentation, and provide additional documentation that exhibits good faith efforts to meet the ethanol blending requirement.
- (3) Retroactively, due to sudden and unforeseen circumstances beyond the control of the distributor (such as war, strikes, lockouts, or acts of God), the distributor shall notify the petroleum commissioner, in a manner allowed by the petroleum commissioner, within 30 days of the event, of the distributor's intent to request an exemption, the reason for the exemption

request, and the anticipated period of the exemption request. The distributor shall submit a formal request for exemption within 60 days of the event. If the exemption request is subsequently denied, penalties for nonconforming fuel may be assessed during the retroactive period if it is found that such request was submitted in bad faith by a distributor. Notwithstanding the foregoing, while a request for an exemption is pending and prior to the issuance of a written determination as to whether the distributor's request is granted, no assessment or accrual of penalties shall occur.

(f) Requests for exemption shall be signed and certified by the chief executive officer or other authorized officer of the company and addressed to the Hawaii State Department of Business, Economic Development and Tourism, Petroleum Commissioner, PO Box 2359, Honolulu Hawaii, 96804, or to such other address as the commissioner may post or announce on the Department website.

(g) The petroleum commissioner shall endeavor to provide to the distributor, within 45 days of receipt of a request that complies with this section, a written determination as to whether the distributor's request has been granted or denied.

(h) While a request for an exemption is pending and prior to the issuance of a written determination as to whether the distributor's request is granted, no assessment or accrual of penalties shall occur. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

SUBCHAPTER 4 - VIOLATIONS, SEVERABILITY AND ENFORCEMENT

§ 15-__-11 Violations. Any person who engages in a practice which does not comply with the requirements of this chapter or exemption issued pursuant thereto shall be in violation of this chapter

and shall be subject to enforcement action by the petroleum commissioner. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-12 Severability. If any provision of this chapter is held invalid, the invalidity shall not affect the remainder of this chapter and, to this end, the provisions of this chapter are severable. [Eff.] (Auth: HRS § 486J-10) (Imp: HRS § 486J-10)

§ 15-__-13 Referral to attorney general. The petroleum commissioner shall refer any violations of any provision of this chapter to the attorney general, who may exercise appropriate legal or equitable remedies available to the State. [Eff.] (Auth: HRS § 486J-9(b)) (Imp: HRS § 486J-9(b))



Tesoro Hawaii's Position on Ethanol

POSITIONS:

Oppose Ethanol Mandate

Tesoro Hawaii is opposed to the state's mandate that gasoline manufacturers and distributors such as Tesoro sell blended gasoline that contains 10 percent ethanol. We are concerned that the mandate will result in only limited local production of ethanol using only the current molasses production for the feedstock. This will not serve the state's or Tesoro's interests.

OVERVIEW:

The Ethanol Mandate is Not Required to Achieve the State's Goals

There is an existing statute that mandates petroleum distributors blend 10% ethanol in gasoline. Regulations are now being drafted to implement the mandate, led by the state Department of Business, Economic Development & Tourism (DBEDT) through the Hawaii Fuel Ethanol Working Group.

Unlike the Mainland where ethanol is used as a required gasoline oxygenate, the state is pursuing ethanol in Hawaii in order to achieve important local goals that include helping local agriculture and our overall economy and energy self-sufficiency. These goals can be better achieved without the mandate.

Tesoro is concerned that if we are not careful, the ethanol mandate will not lead to significant local ethanol production. If we have only limited "token" production of ethanol from the current molasses volume, there will be very few new jobs, no new agriculture and little, if any reduction, in the state's dependency on imported energy. We will end up subsidizing out-of-state importation of ethanol on a large and permanent basis. This will result in replacing one source of out-of-state energy with another out-of-state energy source at a high cost to the state and Tesoro.

If, despite our best efforts, the mandate is left in place, the state should (1) extend the General Excise Tax (GET) exemption; (2) provide tax credits for Tesoro's and other distributors' significant infrastructure costs; (3) reconcile the increased costs of ethanol blended gasoline with the pending price cap legislation; (4) provide a products liability waiver; (5) provide calendar year averaging; (6) extend the time period for the distribution infrastructure; and (7) condition the mandate on significant local ethanol production actually being available and not merely promised, and linked to doing more than just diverting the current molasses volumes.

RATIONALE:

EPA Does Not Require Gasoline-Ethanol Blend in Hawaii

Tesoro Hawaii believes the emerging local ethanol industry can provide the state the benefits of supporting the agriculture industry and our economy. However, since there is no Environmental Protection Agency (EPA) requirement to use oxygenated gasoline blended with ethanol in Hawaii as there are in other U.S. cities, local ethanol supplies could be exported to California where there is a high demand.

Ethanol is the only viable additive for reformulated oxygenated gasoline since methyl tertiary-butyl ether (MTBE) is no longer used, and this is driving the current demand. Consideration should be given to eliminate the ethanol mandate in Hawaii and allow ethanol producers to benefit from the significant demand for their product on the West Coast.

Ethanol Mandate Does Not Work With Gasoline Price Cap Law

It is important to point out that the price cap law currently does not make a distinction between conventional gasoline and the gasoline-ethanol blend and does not allow for any corresponding adjustments. This is a case where severe over-regulation is putting local companies such as Tesoro Hawaii in a difficult position. There is some relief with GET and federal tax exemptions for using ethanol; however, this can only be realized at the retail level, not the wholesale or rack level, which is the majority of Tesoro Hawaii's gasoline business.

Potential for Economic Benefits Without Added Costs

Tesoro Hawaii believes that if ethanol production occurs in Hawaii, the producer will enjoy the existing demand for the product outside Hawaii without the state and its residents incurring the costs resulting from the mandate. Exporting the ethanol preempts such adverse effects to the state as the resultant reduced state tax revenues, the costs for additional investment in ethanol storage facilities by gasoline distributors, reduced gas mileage for Hawaii consumers, and ultimately, increased costs for Hawaii's motorists because of the higher costs of ethanol, its handling and storage, and the loss of fuel economy. In addition, large plants may provide a better BTU conversion, which serves important environmental goals.

PRECAUTIONARY MEASURES NEEDED: Tesoro Hawaii has a number of other concerns relating to the local ethanol production, which we believe need to be addressed as follows:

Supply Issues:

The Reality of No Local Ethanol Supply

Statewide, about 400 million gallons of gasoline are sold per year. Based on the 10 percent mandate, 40 million gallons of ethanol would be needed each year in Hawaii. Targeting even 85% of 40 million gallons of local ethanol production would dramatically increase the amount of agricultural feedstock needed and would require a corresponding

increase in agricultural production to make up the difference. This amount also matches the facility tax credit amount.

If ethanol were imported into the state, the only beneficiaries would be the out-of-state ethanol producers at the expense of Hawaii's residents and businesses. If adequate local production of ethanol does not come to fruition, the prospect of repealing the ethanol mandate could become a reality. This would be economically disadvantageous to Tesoro and others who are forced to invest in distribution and storage facilities to accommodate the ethanol.

Infrastructure Investment Issues:

No Assistance for Significant Infrastructure Investment

Ethanol must be shipped and stored as a separate product until it is blended with gasoline at terminals on Oahu and the neighbor islands. The current law provides generous tax credits to ethanol producers for their capital investments; however, these same benefits are not extended to petroleum distributors such as Tesoro Hawaii. This is inequitable because distributors would be subject to significant upfront costs to build infrastructure such as tanks to contain ethanol for blending. This would be the case especially if there is no local supply and Tesoro Hawaii would have to import ethanol to meet the requirements of the mandate. Tesoro urges that producers, distributors and others impacted by any requirements to provide ethanol be extended similar benefits to assure the recapture of the investments and increased operating expenses that will be incurred.

Financial Liability and Exposure for Refiners and Distributors:

Costs Unique to Refiners and Distributors

Distributors such as Tesoro Hawaii will lose revenue because volatile components, normally present in gasoline, must be removed when blended with ethanol to reduce the gasoline's Reid Vapor Pressure, which affect the ignition performance. These components include butanes and pentanes that must be exported at much lower prices; they cannot be blended into gasoline. This further erodes the economic viability of Tesoro's refining operations and threatens the viability of one of the few value-added manufacturing operations in Hawaii. For this reason, Tesoro would request that the GET exemption on ethanol-blended gasoline be extended for an additional eight years if the mandate is forced on us.

Product Liability Waivers Needed

Since Tesoro Hawaii does not have oversight of the ethanol production facilities or is involved in quality control of the ethanol it receives, Tesoro Hawaii has requested a product liability waiver for distributors against claims for motor vehicle damage if we are forced to use ethanol in our gasoline.

Utilize Calendar Year Average

The mandate requires that 85 percent of gasoline sold by a distributor contain 10 percent ethanol each month. Since there may be operational issues at an ethanol plant, refinery or terminal, Tesoro Hawaii proposes using an **average** of 85 percent over a calendar year to

account for such unforeseen circumstances to remain in compliance with the mandate if the mandate is not repealed.

CONCLUSION

Tesoro Hawaii Committed to Working Toward the Best Solutions

Despite its opposition to the mandate, Tesoro Hawaii is committing to working with the state on this important issue so that we can achieve the state's goals for ethanol. These goals require more than token local production of ethanol, but do not require the mandate.